An Introduction to Islamic Finance

Islam is the world's third monotheistic religion and comes from the same Semitic heritage as Judaism and Christianity. From the very beginning, Islam acquired its characteristic ethos as a religion uniting both spiritual and temporal aspects of life, seeking to regulate not only the individual's relationship with God, but also human relationships in a social setting. Thus, in addition to religious principles, there is Islamic law and secular institutions governing both individual behavior and societal interactions.

The purpose of this note is to provide an introduction to Islamic Finance, one of the most important aspects of Islamic socioeconomic doctrine.[1] Because Muslims, or followers of Islam, now comprise one quarter of the world's population and Muslim countries control approximately 10% of global GNP, they represent an increasingly important segment of the global economy. Nevertheless, few people know much about Islamic finance other than the rudimentary fact that interest is forbidden. This note begins by examining the religious and legal foundations of Islamic finance, and then describes the rise of Islamic financial institutions. Although the field of Islamic banking is relatively small, with total assets of approximately $150 billion in 1997, the market is growing at 15%-20% per year, and new developments are happening regularly. The final sections discuss some recent innovations such as Islamic project finance as well as the challenges facing Islamic banks as they seek to play a role in financing the economic development of Islamic countries.

Religious and Legal Background of Islamic Finance

The Arabic term *Islam*, literally 'surrender,' illustrates the fundamental religious aspect of Islam—that the believer accepts his or her surrender to the will of God, or *Allah* as He is known in Arabic. *Allah* is viewed as the sole God—creator, sustainer, and restorer of the world. The will of

[1] Some people view the term 'Islamic' as applied to banking or finance as inappropriate and even offensive based on the belief that Allah's word applies to both Muslims and non-Muslims alike. As a result, they prefer terms such as profit bank and equity investor to Islamic bank or Islamic investor (Frank Vogel and Samuel Hayes, *Islamic Law And Finance: Religion, Risk, and Return*, Kluwer Law International, The Hague, The Netherlands: 1998, p. 27.)

Research Associates Fuaad A. Qureshi and Mathew M. Millett prepared this note from public sources under the supervision of Professor Benjamin C. Esty as the basis for class discussion. This note is intended to be used in conjunction with The International Investor: Islamic Finance and the Equate Project, *HBS No. 200-012. Much of the background material on Islamic finance comes from the book* Islamic Law and Finance: Religion, Risk, and Return, *by Frank Vogel and Samuel Hayes (Kluwer Law International, The Hague, The Netherlands, 1998).*

Allah, to which man must submit, is made known through the *Qur'an,* the sacred scripture which Allah revealed to his messenger, Mohammed. According to Islamic theology, the purpose of the existence of man, as of every other creature, is submission to the Divine Will. With a deep-seated belief in Satan's existence, man's fundamental role becomes one of moral struggle. For example, Satan plants the idea that man will become poor by giving to the needy. Allah, on the other hand, promises prosperity in exchange for such generosity, and threatens those who hoard wealth with eternal damnation.

As this example shows, Islam governs the relationship between God and His creations. The entire body of rules guiding the life of a Muslim is known as the *Shari'ah* which is derived from the word meaning path. Due to the absence of a strict delineation between the religious and secular aspects of life, Islam is more accurately described as a comprehensive code of life covering legal, ethical, and social matters. Only those believers whose lives conform to *Shari'ah* will be granted entrance to heaven.

Rather than a codified body of law, the *Shari'ah* is an ever-expanding interpretation of religious law. The provisions of *Shari'ah* are derived through the discipline of *fiqh,* or jurisprudence. *Fiqh* is man's attempt to understand divine law based several sources and methods:

(a) The *Qur'an*: Muslims believe the *Qur'an* is the actual word of God as transmitted to the Prophet Mohammed (570-632 AD).

(b) The *Sunna*: Prophet Mohammed's sayings and deeds—which are known collectively as the *Sunna,* or tradition—are codified in the *Hadith.* The *Sunna* provide further insight into the meaning of the *Qur'an.*

(c) *Ijma*: In essence, *Ijma* is the agreement of the Islamic community as a basis for legal decision making. The introduction of *Ijma* in the second century of Islam aided the standardization of legal theory, allowing for the resolution of individual and regional differences of opinion.

(d) *Qiyas*: *Qiyas* is the derivation of new judicial decisions through the use of strict analogy based on the texts of the *Qur'an* and *Hadith.* This technique is one of the main avenues for the evolution of the *Shari'ah.*

(e) *Ijtihad*: *Ijtihad* is the opinion of an Islamic jurist on a particular issue based on the *Qur'an* and *Sunna.* It is required to find the legal or doctrinal solutions to problems not previously tackled by the *Shari'ah.*

The *Shari'ah* lays down four main prohibitions which serve to distinguish Islamic finance from 'conventional' or 'Western' finance.[2] One of the most important principles of Islamic finance is the scriptural injunction against interest, or *riba.* Instead, profit is the just return for someone who accepts the risks of ownership. This prohibition is intended to prevent exploitation and to maximize social benefits; it highlights the emphasis on social welfare over individual welfare in Islam. Interestingly, even Adam Smith noted the prohibition of interest as a hallmark of Islamic finance in his book *The Wealth of Nations.*[3]

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[2] Allen and Overy, *Islamic Finance* (Dubai, 1993), p. 2.

[3] Smith argues that even in economies where interest is proscribed, people will not lend without considering potential profits, as well as the potential cost of default. The latter is incorporated into the interest rate—and is one of the reasons he gives to explain high interest rates in Islamic economies. (*The Wealth of Nations* (Chicago, Ill.: University of Chicago Press, 1976), Book I, Chapter IX).

Additionally, the *Shari'ah* declares uncertainty, or *gharar*, in contracts as un-Islamic. This concept is best illustrated by example. The sale of a building prior to construction would be forbidden due to the uncertainty of its existence at the time of the contract. However, the sale of a building for which ground has been broken would be legal. The subtle nuance here is that the former relies on the occurrence of an uncertain event for its fulfillment, namely the commencement of construction. Islamic law also declares gambling, or *masir*, as unacceptable because it can lead to immorality (the compulsion to gamble) and other social evils (poverty). This restriction has direct implications in the dealings of modern financial instruments such as futures and options, which may be deemed illegal due to their speculative nature. And finally, the *Shari'ah* prohibits the use of certain products such as pork and alcohol as well as commercial transactions dependent upon these products.

Each of these concepts, particularly *riba*, *gharar*, and *masir*, though strictly forbidden in theory, generate a tremendous amount of debate when applied to every day life. To resolve these debates, particularly in the presence of technological and institutional innovation, there are *fiqh* academies composed of Islamic legal and religious scholars. Through academic debate, the scholars generate *fatwas* or legal rulings on various topics.

More than the interpretive uncertainty surrounding various topics, the real issue that separates Islamic countries is the degree to which the state and government integrates Islamic principles into everyday life. **Exhibit 1** provides a demographic breakdown of the Muslim population by country. It shows not only that Muslims comprise more than a quarter of the world's population, but also that Muslims represent the religious majority in large number of countries.

Nationalistic, cultural, and political views tend to mix with religion, resulting in varying degrees of religious intensity. Countries where the entire economic system has aligned with Islamic principles tend to be those that have an Islamic government (e.g., Pakistan, Iran, and Sudan).[4] More moderate governments (Bahrain, Brunei, Kuwait, Malaysia, Turkey, and United Arab Emirates) embrace Islamic banking though support a dual banking system with conventional banks. Other countries such as Egypt, Yemen, Singapore, and possibly Indonesia neither support nor oppose Islamic banking. And finally, there are countries that actively discourage the creation of a separate Islamic-banking sector (Saudi Arabia[5] and Oman).

Islamic Financial Institutions

The independence of Islamic countries following World War II combined with the renaissance of Islamic sentiment set the stage for the modern era of Islamic finance. The first Islamic financial institution, a small Egyptian institution named Mit Ghamr Local Savings Bank, was formed in 1963. Early development was slow and did not accelerate until the oil boom in the 1970s. Prior to this time, a few ruling families and a select group of businesses controlled the majority of Middle Eastern wealth. Given limited alternatives to invest 'Islamically', they chose to invest in conventional financial institutions and did so with little social recrimination. The influx of petro-dollars created a larger segment of wealthy citizens looking for ways to invest their savings in conformance with the *Shari'ah*. In response to this growing demand for Islamic financial institutions and renewed interest in Islamic principles, financial institutions began to appear throughout the Islamic world.

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[4] Vogel and Hayes, p. 11.

[5] The Saudi Arabian government believes that by declaring certain financial institutions as Islamic, they would be implicitly branding other institutions as un-Islamic. For this reason, it does not distinguish Islamic banks in the chartering process.

The greatest single boost for the resurgence of Islamic financial practices occurred in 1973, with the founding of the Islamic Development Bank (IDB) in Jeddah under the auspices of the Organization of the Islamic Conference (OIC). The purpose of the IDB was to promote economic development in the OIC's member countries, both individually and jointly, through the use of Islamic financial techniques.

By 1997, there were 176 Islamic financial institutions, with $148 billion of assets, operating in over fifty countries. Although these institutions are collectively referred to as Islamic banks, this term is somewhat of a misnomer because there are many types of institutions including commercial, investment, and development banks. **Exhibit 2** shows the growth of Islamic financial institutions from 1993 to 1997; **Exhibit 3** shows the geographical distribution of these institutions as of 1997. As one might expect, the majority of the institutions and the assets are in the Middle East. **Exhibit 4** lists the 20 largest Islamic banks, based on total assets. The largest institution, the $22 billion Bank Melli Iran, is roughly equal to the fiftieth largest U.S. bank holding company at the time.

In drawing their operating guidelines from the *Shari'ah*, Islamic banks differ from their Western counterparts in several ways. First, they conduct business in an interest-free manner—to avoid *riba*. The relationship between these banks and their customers is not the standard one of creditor and debtor, but rather one of the sharing in financial risks and rewards. A second difference is the fact that profit is not the sole purpose of an Islamic bank. These banks must ensure that funds are invested in conformance with religious principles. A *Shari'ah* advisory committee, comprised of Islamic jurists, oversees the operation of each institution. These committees, which range in size from one to seven members, typically meet quarterly to discuss specific products and transactions.[6] Given the evolutionary nature of business and finance, it is the committee's job to determine what is permissible, or *halal*, and what is unlawful, or *haram*. Like public accounting firms, they provide annual reports in which they assess whether an institution has "acted in compliance with the rules and regulations of the Islamic *Shari'ah*." **Exhibit 5** provides an example of a typical report by a *Shari'ah* committee for The International Investor, an Islamic investment bank located in Kuwait.

Islamic Financial Instruments

Islamic banks derive their deposit base from two main sources. Transactions deposits are similar to conventional demand deposits except they do not pay interest. Islamic banks guarantee the nominal value of transactions deposits even though most Islamic countries do not have deposit insurance funds, such as the Federal Deposit Insurance Corporation in the United States, to guarantee deposits. In contrast, investment deposits are like shares in a firm. Instead of paying a fixed return determined ex-ante as interest, the bank pays a return based on any profits on its investments. For this reason, the nominal value of investment deposits is not guaranteed. Along with equity capital, deposits are the main source of liabilities for Islamic financial institutions.

Banks have a wide array of financial instruments at their disposal in which to invest these funds. As in conventional finance, these instruments may be divided into equity-like instruments (i.e., those that represent residual claims) and debt-like instruments (i.e., those that represent fixed claims). Below there are brief descriptions of the main instruments used by Islamic institutions.[7]

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[6] Vogel and Hayes, p. 49.

[7] See Allen and Overy (1993) and Clifford Chance, "Islamic Banking and Finance" (October 1992).

Equity-like Instruments (Residual Claims)

(a) ***Modaraba* (trust financing)**: Under a *modaraba* contract, an Islamic financial institution provides the capital to finance a project while an entrepreneur provides management skills. In financing a project, the institution does not employ its own funds—only the funds of its investors. In many respects, such contracts are very similar to Western limited partnerships. After paying for management skills, the financial institution deducts its own fee from the enterprise's profits, for managing its investor's funds. Remaining profits are distributed to investors.

(b) ***Mosharaka* (profit sharing)**: This contract is similar to a *modaraba* except that the partners are not confined to distinct roles as either financier or manager. Instead, the provision of capital and management of the enterprise are shared.

(c) **Preferred Stock**: While the *Shari'ah* does not sanction the offering of different dividend payoffs to shareholders, it is legal to utilize different classes of common stock.

Debt-like Instruments (Fixed Claims)

(a) ***Morabaha* (cost-plus financing)**: In a *morabaha* contract, an Islamic financial institution purchases a commodity and then resells it to a customer at a later date for a predetermined price. The institution's profit is the difference between the price paid for the commodity and the price paid by its client. The client may opt for either immediate payment or deferred payment. Such contracts tend to come under fire for violating the prohibition of predetermined profit, but are justified by the fact that the client is not compelled to repurchase the goods from the institution. This structure creates a certain degree of risk on the part of the institution, and its profits are directly derived from that risk. In general, *morabaha* contracts tend to be short-term agreements.

(b) ***Ijara* (leasing)**: Under an *ijara* contract, an Islamic institution purchases an asset and then leases it for a rate that is periodically reviewed and possibly adjusted. The profits from the lease are justified because the financial institution owns the asset in question and, therefore, assumes risk for its performance. While the option for the lessor to purchase the asset at the end of the lease period is deemed illegal due to the uncertainty inherent in options, there are versions of *ijara* contracts where the client agrees up-front to purchase the asset at the end of the lease period.

(c) ***Mukarada***: This instrument is similar to a revenue bond issued by an Islamic bank to finance a specific project. Investors have no voting rights, but are entitled to a proportional interest in profits and losses of the venture.

(d) ***Salam* (forward purchase)**: A *salam* contract is a forward purchasing agreement in which the investor or institution directly pays the manufacturer for a commodity to be produced and delivered on a fixed date. The possibility of the lack of a market at that future date incorporates the element of risk for the lender, rendering such transactions legal. Payment is made at the time the contract is signed.

(e) ***Istisna'* (commissioned manufacture)**: In an *istisna'* contract, one party agrees to buy goods made by a second party with payments occurring at some future date or dates. In some cases, an Islamic bank may represent the end user. Payments are often geared to manufacturing milestones or completion. The primary distinction between an *istisna'* and *salam* is that the former is used for goods that otherwise would not exist (see Hayes and Vogel, p. 147).

Exhibit 6 shows the degree to which Islamic financial institutions employ these instruments. In recent years, *mosharaka* contracts have gained significant popularity as a mode of financing, while *modaraba* and *morabaha* have experienced slight declines.

Current Challenges

Although the discipline of Islamic finance has progressed rapidly over the last three decades, several obstacles remain as impediments to future growth. Similar to conventional financial institutions, Islamic financial institutions face the problems of adverse selection and moral hazard. Potential bad credit risks will seek out institutions willing to lend funds on a profit-loss basis. Without the incentive to utilize the funds efficiently, or at least be accountable for a return on it, entrepreneurs may take advantage of banking institutions. As a result, the lender is at the mercy of the honest nature of the borrower. Fortunately, honesty and contractual responsibility are mandated through other religious principles.

A second, and potentially more serious problem, has to do with asset-liability management. Islamic institutions have few long-term liabilities thereby restricting their ability to make long-term investments. If they were to invest in long-term assets, the maturity mismatch would expose them to liquidity and profit risks. This problem is exacerbated by the absence of several institutional and product innovations that exist in conventional financial systems: deposit insurance encourages long-term deposits; interest-rate swaps allow institutions to minimize interest-rate exposure, interbank lending helps resolve temporary liquidity problems; and a lender of last resort helps resolve more serious liquidity problems. More importantly, it is not just a matter of time before these elements enter the Islamic financial system. Many of them, such as interest rate swaps, are forbidden according to *Shari'ah*.

And finally, the proliferation of Islamic finance will be hampered by the absence of standardization both in terms the instruments that are considered legal according to religious principles and in terms of the standards for financial reporting—there are no generally accepted accounting standards for Islamic financial institutions.[8] One problem for firms conducting cross-border transactions is that certain products and services that are deemed lawful by one *Shari'ah* committee may be deemed unlawful by another. This lack of interpretive consistency hampers business transactions by injecting a level of uncertainty in the process.

Future Developments

Given the fact that more than a quarter of the world's population is Muslim, the rising interest in Islamic finance should come as no surprise. The assets in Islamic financial institutions are growing rapidly as is the number of Islamic institutions. To capture some of this growing market, conventional banks are opening Islamic divisions as well as 'Islamic windows' in existing branches: Citbank recently opened Citi Islamic Investment bank while ABN AMRO recently opened ABN AMRO Global Islamic Financial Services, both in Bahrain[9]. As more and more Muslims opt to invest according to *Shari'ah*, the opportunity are bound to grow.

Several recent developments attest to the growing interest in and importance of Islamic finance. Over the past three years, financial institutions have created several new Islamic investment funds—see **Exhibit 7**. Dow Jones, recognizing the growing investor demand for Islamic equity, recently created the Dow Jones Islamic Market Index (DJIM) which tracks 600 companies whose operations conform to *Shari'ah* principles.[10]

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[8] Clifford Chance, p. 6.

[9] "A market in the making," *The Banker*, February 1998, p. 57.

[10] "Dow Jones plans to launch Islamic market index," *The Wall Street Journal*, February 8, 1999.

Without a doubt, one of the biggest challenges in the Islamic world, and therefore one of the biggest opportunities, is infrastructure development. By one estimate, the potential market for infrastructure projects in the Middle East alone is $45-$60 billion over the next ten years. In fact, there are now almost 300 infrastructure projects pending in the Middle East—not counting those in the petroleum sector.[11] Financing these projects will outstrip the capabilities of local banks and governments, especially given the fact that most of the countries with large Muslim populations are relatively poor. As a result, economic development will require international capital. The key will be to create structures that integrate international capital with Islamic religious principles.

One such structure, known as 'co-financing', involves the side-by-side use of conventional and Islamic funds in a single deal. Pakistan's $1.8 billion Hub River Power project, which was signed in 1994, was the first transaction to use a co-financing structure, albeit a temporary one. Since then, there have been several other co-financed deals including the $1.1 billion Thurayya Satellite Network which was signed in 1998 and contained a $100 million Islamic tranche.[12] Another recent example of the attempts to combine conventional and Islamic funds is the Islamic Development Bank's infrastructure fund. The IDB plans to raise $1 billion of equity capital and another $500 million in Islamic funds for infrastructure investments in member countries; the targeted return is 18-20%.[13]

Interestingly, a banker working on a recent transaction in Malaysia encountered the opposite problem of not having sufficient conventional funds.

> The incentive to include an Islamic finance tranche in the LR2 (Light Rail Transit System 2) project was to broaden the lender base. There was some concern that funding within the conventional market for all the projects that are coming on stream in Malaysia would be insufficient. There was therefore the risk that we would go to the conventional market for all of the financing and come up short.[14]

Through innovations like co-financing, Islamic countries will be able to fund development projects while simultaneously meeting the interests of Islamic investors and citizens. To do so, however, Islamic bankers will have to resolve ever more complex legal, financial, and religious issues. The continued evolution of *Shari'ah* principles is necessary not only for the growth of Islamic financial institutions, but also for the efficient development of Islamic countries.

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[11] *Project Finance*, p. 20.

[12] "You cannot afford to wait," *Project Finance*, July 1999, p. 20.

[13] "Islamic institutions plan private infrastructure fund," *International Trade Finance*, October 9, 1998, p. 6.

[14] Sara Khalili, "Unlocking Islamic Finance," *Infrastructure Finance*, April 1997, p. 19.

Exhibit 1 Muslim Population Statistics (1996)

Country	Muslim Population (millions)	Percent of Country's Total Population
Indonesia	196	95%
India	133	14
Pakistan	125	97
Bangladesh	104	85
Nigeria	77	75
Iran	65	99
Turkey	62	100
Egypt	59	94
Ethiopia	37	65
China	36	3
Morocco	29	99
Algeria	28	99
Sudan	26	85
Afghanistan	22	100
Iraq	20	97
Uzbekistan	20	88
Saudi Arabia	19	100
Tanzania	18	65
Syria	14	90
Yemen	13	99
Philippines	10	14
Malaysia	10	52
United States	9	4
Somalia	9	100
Cote d'Ivoire	8	60
Total of Top 25 Countries	1,259	
Total Number of Muslims	1,482	
Total World Population	5,771	
Muslim Population as a Percent of Total	25.7%	

Source: http://islamicweb.com/, casewriter estimates

Exhibit 2 Financial Highlights of the Islamic Market: 1993-1997[a]

	1993	1994	1995	1996	1997	4-year Compound Growth Rate
Number of Islamic Banks	100	133	144	166	176	15.2%
Financial Highlights ($ in thousands)						
Capital	2,390	4,954	6,308	7,271	7,333	32.3
Assets	53,815	154,567	166,053	137,132	147,685	28.7
Funds Under Management	41,587	70,044	77,516	101,163	112,590	28.3
Reserves	N/A	2,383	2,939	5,746	3,076	8.9
Net Profits	N/A	809	1,245	1,684	1,238	15.2
Sectoral Financing (%)						
Trading	31%	27%	30%	31%	32%	
Agriculture	13	13	9	8	6	
Industry	30	28	19	19	17	
Services	11	15	13	13	12	
Real Estate	N/A	5	12	12	16	
Other	15	12	17	18	16	
Total	100%	100%	100%	100%	100%	

Source: "Directory of Islamic Banks and Financial Institutions - 1997," *The International Association of Islamic Banks*, Jeddah.

[a]Includes other Islamic financial institutions such as Islamic investment banks.

Exhibit 3 Regional Islamic Banking Highlights (1997)

Region	Number of Banks[a]	Capital		Assets		Deposits		Reserves		Net Profit	
		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
South Asia[b]	51	884,048	12%	39,272,976	27%	25,664,913	23%	1,077,163	35%	249,792	20%
Africa	35	202,197	3	1,573,846	1	730,025	1	82,087	3	19,750	2
Southeast Asia[c]	31	149,837	2	2,332,204	2	1,887,710	2	160,136	5	45,659	4
Middle East	26	3,684,136	50	83,136,100	56	69,076,443	61	382,286	12	252,185	20
Gulf Cooperation Council[d]	21	1,787,395	24	20,449,637	14	14,088,581	13	1,353,167	44	603,642	49
Europe and America	9	616,795	8	908,922	1	1,139,541	1	20,613	1	66,707	5
Asia[e]	2	3,452	0	5,727	0	2,563	0	24	0	282	0
Australia	1	5,219	0	5,590	0	N/A	0	50	0	224	0
Total	176	7,333,079	100%	147,685,002	100%	112,587,213	100%	3,075,526	100%	1,238,241	100%

Source: "Directory of Islamic Banks and Financial Institutions - 1997," *The International Association of Islamic Banks*, Jeddah.

[a]Includes other Islamic financial institutions such as Islamic investment banks.

[b]South Asia includes Bangladesh, India, and Pakistan

[c]Sotheast Asia includes Brunei, Indonesia, Malaysia, and the Philippines.

[d]The Gulf Cooperation Council is a political, economic, social, and regional organization established in 1981 by UAE, Bahrain, Saudi Arabia, Oman, Qatar, and Kuwait.

[e]Asia includes Russia and Kzakhstan.

Exhibit 4 Top 20 Islamic Banks Based on Total Assets (1997)[a] (amounts in thousands)

Name of Institution	Country	Date of Financials	Assets	Paid-in Capital	Deposits	Reserves	Net Profit	Return on Capital	Return on Assets
Bank Melli Iran	Iran	Mar-97	$22,415,451	$654,660	$21,709,740	$10,563	$61,153	9.3%	0.3%
Bank Sedarat Iran	Iran	Mar-97	11,771,051	309,334	7,664,060	4,105	N/A	N/A	N/A
Bank Tejarat	Iran	Mar-97	10,526,730	326,360	9,673,260	13,210	10,910	3.3	0.1
Iraqi Islamic Bank for Dev. & Invest.	Iraq	Dec-96	9,900,000	402,000	10,900,000	24,000	N/A	N/A	N/A
Al-Rajhi Banking & Investment Corp.	Saudi Arabia	Dec-97	9,369,354	400,000	6,697,177	976,460	347,188	86.8	3.7
National Bank of Pakistan	Pakistan	Dec-95	9,348,361	72,992	6,081,255	186,171	90,000	123.3	1.0
Bank Sepah	Iran	Mar-97	9,026,980	227,920	7,322,930	2,330	13,680	6.0	0.2
Bank Mellat	Iran	Mar-97	6,966,776	201,667	5,083,632	71,171	7,999	4.0	0.1
Habib Bank	Pakistan	Dec-97	5,803,520	56,265	4,800,264	218,346	(87,898)	(156.2)	(1.5)
Kuwait Finance House	Kuwait	Dec-97	5,269,317	168,503	428,110	249,497	121,813	72.3	2.3
United Bank	Pakistan	Dec-93	5,087,843	49,242	3,703,893	69,060	9,146	18.6	0.2
Muslim Commercial Bank	Pakistan	Dec-96	4,070,930	45,377	2,815,666	29,788	2,574	5.7	0.1
Agricultural Bank of Iran	Iran	Mar-96	3,023,818	233,327	1,000,990	11,817	11,239	4.8	0.4
Agricultural Dev. Bank of Pakistan	Pakistan	Dec-95	1,982,297	103,680	80,821	103,654	6,297	6.1	0.3
Dubai Islamic Bank	UAE	Dec-96	1,935,480	135,580	1,753,880	19,870	15,520	11.4	0.8
Bank of Industry & Mine	Iran	Mar-97	1,917,738	729,345	151,049	30,906	39,924	5.5	2.1
Faisal Islamic Bank of Egypt	Egypt	May-97	1,843,600	132,000	1,787,800	3,200	N/A	N/A	N/A
Citibank Pakistan	Pakistan	Dec-93	1,382,005	53,107	802,272	N/A	14,180	26.7	1.0
Bank Islam Malaysia Berhad	Malaysia	Dec-97	1,233,379	37,057	1,032,372	41,348	13,153	35.5	1.1
Bank Refah Kargaran	Iran	Mar-96	1,160,594	31,394	730,414	55,553	3,697	11.8	0.3
			$124,035,224	$4,369,810	$ 94,219,585	$2,121,049	$ 680,575	15.6%	0.5%
Grand Total: 176 Islamic Banks in 38 Countries			$147,685,002	$7,333,079	$112,589,776	$3,075,526	$1,238,241	16.9%	0.8%

Source: "Directory of Islamic Banks and Financial Institutions—1997," *The International Association of Islamic Banks*, Jeddah.

[a]Includes other Islamic financial institutions such as Islamic investment banks.

Exhibit 5 The International Investor 1998 Sharia Committee Report

report of the TII Sharia committee

In the Name of God, the Merciful, the Compassionate

Report of the Fatwa and Sharia Supervisory Committee
for the period 3 January 1998 through 31 December 1998

Praise be to God, the Lord of the Worlds, and prayer and peace be upon our Prophet Mohammed, his family, companions and followers.

The Fatwa and Sharia Supervisory Committee of The International Investor held several meetings during 1998. During these regular meetings, all matters such as enquiries and contracts relating to the company's new operations of the year, which were referred to the committee by the Management of the company, were discussed and appropriate recommendations, decisions and Fatwas were made.

In the light of the statements made and submitted by the committee's secretary, the committee hereby declares that the company has acted in compliance with the rules and regulations of the Islamic Sharia in respect of all its contracts and transactions.

Ahmed Bezai'a Al-Yaseen Chairman
Dr Khalid Al-Madhkour Member
Dr Mohammed Fawzi Faidhulla Member
Dr Mohammed Abdul Ghaffar Al-Sharif Member

In addition to The Fatwa and Sharia Supervisory Committee, The International Investor has been privileged to be guided, since its inception, by an International Advisory Sharia Committee, outside Kuwait. This Committee has assisted with further scrutinising of the company's activities, to ensure that they are compatible with the principles of Islamic Sharia.

This Committee comprises the following members:
His Eminence, Sheikh Abdulla Ibn Abdul Aziz Ibn Aqeel Chairman
His Eminence, Sheikh Saleh Ibn Abdul Rahman Al-Hussain Deputy Chairman
His Eminence, Sheikh Mustafa Ahmed Al-Zarqa'a Member
His Eminence, Sheikh Abdul Rahman Ibn Abdulla Ibn Aqeel Member and Secretary

Source: The International Investor 1998 Annual Report.

Exhibit 6 Modes of Financing by Islamic Banks: 1994-1997

	1994	1995	1996	1997
Morabaha	41.5%	45.6%	40.3%	37.0%
Mosharaka	8.2	8.7	7.2	19.0
Modaraba	12.6	15.3	12.7	6.0
Ijara	8.7	9.7	11.5	9.0
Others	29.0	21.1	28.3	29.0
Total	100%	100%	100%	100%

Source: "Directory of Islamic Banks and Financial Institutions - 1997," *The International Association of Islamic Banks*, Jeddah.

Exhibit 7 Recently Established Islamic Investment Funds

Fund	Type	Year Launched	Financial Institution	Size ($ millions)
IIBU Fund II Plc.	Leasing	1994	United Bank of Kuwait	$ 51.5
Faysal Saudi Real Estate Fund	Real Estate	1995	Faysal Islamic Bank of Bahrain	27.0
GCC Trading Fund	Trading	1996	GCC Trading Fund	10.0
Oasis International Equity Fund	Equity	1996	Robert Fleming & Co. (UK)	16.6
Faisal Finance Real Estate Income Fund	Real Estate	1996	Faisal Finance (Switzerland) S.A.	100.0
Unit Investment Fund (all tranches)	*Mudaraba* syndication	1996	Islamic Dev. Bank (Saudi Arabia)	500.0
Al Safwa Int'l Equity Fund	Equity unit trust	1996	Al-Tawfeed Co. for Investment Funds	27.0
Ibn Khaldun Int'l Equity Fund	Equity	1996	PFM Group (United Kingdom)	25.0
Adil Islamic Growth Fund	Equity	1996	Faisal Finance (Switzerland) S.A.	10.0

Source: Islamic Financial Systems, Zamir Iqbal, *Finance & Development*, vol. 34, no. 2, International Monetary Fund and the International Bank for Reconstruction and Development, June 1997.